Trade Promotion Challenges and Opportunities

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Trade promotions are as controversial in Canada today as they were back in 1980 when the Ontario Royal Commission of Inquiry into Discounting and Allowances in the Food Industry in Ontario made its report. The main reason for the controversy rests in the following areas:

- Misunderstanding of the purpose of trade promotions.
- Growing magnitude and importance of trade promotions.
- Uses and misuses of trade promotions.

In addition, trade promotions are controversial because they are often seen as a barrier to entry for smaller firms.

The purpose of this paper is to examine some of the issues associated with trade promotions in Canada today. It begins with defining what is meant by trade promotions and examining two of the more prominent promotions used in Canada. The paper finishes with a discussion of how promotions could be more effective.

Progressive Grocer magazine's glossary of industry terms defines trade promotion as "a manufacturer's special offer made to retailers, e.g., advertising allowance, merchandising allowance." Furthermore, "Sales Promotion Concepts, Methods and Strategies," by Blattberg and Neslin asserts that "a trade deal is simply a promotion directed to the members of the channels of distribution." They say that it is important to recognize that it is "push money" intended to push the product to the end user. Trade dealing is a mechanism for the manufacturer to try to induce actions for its direct customer, the retailer. These attempted actions are typically advertising, price discount, and display of the item.

Of course it obviously goes both ways as retailers can also demand promotional moneys from manufacturers in exchange for listing, advertising, discounting and display. The subtlety of trade

promotions from the retailers perspective can range from simple demands for manufacturer discounts to outcome based performance activities.

Retailers and manufacturers have changed trade practices in recent years. However, there is no formal documentation on retail trade practices as they tend to vary from one retailer to another, from one department to another or from one category to another. Nevertheless, there are some trade practices that are similar among retailers.

Over & Above

Today, Over & Above (O&A) is a part of marketing or merchandising programs that manufacturers put together to support sales of a product into a retail chain. O&A is basically a percentage of a manufacturer's sales given back to a retailer usually by auto-deduction on payment. There is no formal definition of Over & Above. It can be defined as deals and allowances (% of sales) that are part of a supplier marketing program prepared in order to obtain listings, keep listings or increase sales made to a retail chain. It can be seen as profit extra margin made over & above the profit margin made the retailer. Marketing programs are typically composed of deals and allowances such as O&A, coop advertising, marketing funds for ads in flyers or in-store specials, in-store demos, rebate volumes and payment terms. The deals and allowances required in a program vary from one retailer to another, and by department.

Historically, O&A has been put in place by retailers to increase the marketing funds paid by suppliers. For example, retailers were increasing the cost of advertising in their flyer from year to year. Therefore, the fixed amount invested by a supplier as Coop Advertising was allowing a decreasing number of ads from one year to another. The concept of O&A was originally extra money paid by a manufacturer to a retailer in a year in order to have the same number of flyer ads as the previous year. In other words, O&A was the price paid by a manufacturer for the increasing cost of flyer advertising.

Today, O&A is essentially a percentage of the sales of a manufacturer deducted by the retailer. The percentage of O&A is relatively similar within a category to create equity among suppliers. This means that long time suppliers pay about the same percentage as the newcomers to a category. These days, O&A is basically money given by the supplier as right to sell into the stores of a retail chain.

Over & Above is now internally named *Vendor Revenue* in Loblaw's financial reports. Just to highlight the importance of O&A, Loblaw has created a management position named *Director, O&A Finance*. The role of this position is to provide financial control and reporting over vendor trade revenues generated by *Manager, O&A Finance* and the category manager.

O&A typically represents 1% to 10% of a supplier's sales given back to a chain. The main problem with O&A is that it tends to grow over the years. It could start at around 2% but within a few years it would reach 4% and 5%. Eventually it can even reach 10%. While that amount is very large, it is also very difficult to refuse a demand to increase the O&A from the retailer. The reason is that in such a case a retailer would promote increasingly a direct competitor to the

manufacturer that would refuse to increase O&A funds. In addition, a manufacturer refusing to increase O&A could face a delisting of several stock keeping units (SKUs).

Listing fees – from $500 to $50,000 per SKU

Listing fees are becoming increasingly expensive. As an example, the dry grocery departments of national chains now request between $10,000 and $30,000 to add a product in this section of the store. It is possible for a manufacturer to avoid listing fees only if the product is highly demanded and the retailer has no other sourcing alternatives. The reality is that pretty much all suppliers now pay listing fees to supermarket chains. However, alternative retailers such as Costco and Walmart do not charge listing fees. Walmart simply expects the lowest or best price from the supplier and the listing fees are not part of the arrangement.

The challenge when discussing listing fees is the fact that retailers do not seem to post consistent lists or policies pertaining to the practice. Clear business policies of retailers simply do not exist. The retailer will not present a list of fees per category or per department to the manufacturer. In fact, it is more typically a number that is thrown on the table by a category manager as "by the way listing fees are $20,000 per SKU for those products". In some cases it seems possible to negotiate a package deal for a few SKUs.

Listing fees are the most controversial of the manufacturer-retailer trade practices. The arguments on the rationale and concerns are time worn. Manufactures will often assert that listing fees can limit the expansion and opportunities of local manufacturers. It is argued that listing fees limit the possibility for small local manufacturers to access supermarket shelves.

For their part, retailers note that there are 30-40,000 items on their shelves. A new item from a manufacturer has to generate returns rapidly or it is costing retailers unnecessarily. For every new item that they place, another has to give way. There is risk associated with placing new, untried items, especially given the high failure rate of new product launches. In addition, retailers are making more of an effort to keep only high performers or necessary items on the shelf. They are not looking for another 'me-too' item. With that said retailers are also looking for new and exciting products that will differentiate them from other retailers. If a manufacturer truly has an innovative entry, the listing fee is likely to be low or non-existent.

Extra terms of 1%, 2% and even more

An example of extra terms is one major grocer's automatic deduction fee, which was imposed on manufacturers in late 2008. The major grocer requested its suppliers to sign a form in which each of them had to agree to an extra deduction fee of 1% for national brand and 2% for private label and to confirm by letter that they agree to these ongoing incremental rebates for all purchases, based on invoice costs. It was applicable across the entire listing base including new items.

This extra term of 1% or 2% represents manufacturer's profit margin given back to the retailer. In this case it was to support the store renovation program. It should be noted that this was forced onto suppliers with little or no choice. The alternative was to see the grocer stopping to buy their products. The problem is that negotiation is not a promising option. It is possible to argue and

debate about these increasing costs but it is likely that the retailer will favour the most cooperative suppliers in its merchandising activities.

Payment terms are usually 2%/10 days or Net 30 days but it seems that 30 days are becoming more often 60 days or even 90 days. These more common late payments could have been influenced by alternative retailers such as Walmart which has standard terms of payment of 90 days. For manufacturers, payment terms of 60 to 90 days instead of 30 days mean that the supplier is financing the retailer during the first 30 to 60 days. Furthermore, that means that the supplier has to use funds other than its sales to finance its own operations.

Some retailers even take off the 2% of the payment while paying in 20 days or even in 30 days. The problem for the supplier is that this is a complex issue for the merchandising department as it requires input from the accounting department. From a practical perspective, Canadian suppliers have found it challenging to get the accounting right on this issue. In the case of Loblaw, for example, it's pretty hard to argue with the fax machine of their payable account office located in Winnipeg. Also when it takes up to 60 and 90 days to receive payment from Sobeys or Metro, its often because the request from the manufacturer is going from one desk to another at their head office. It seems like a small problem but it is irksome and costly.

Unloading fees or more often called lumping fees sometimes can get very expensive. Those fees vary from $50 to over $500 depending on the number of pallets and the time it takes to unload the stock from a truck. Basically, the retailers' distribution centre lift operator normally unloads pallets of stock, but now some retailers ask the manufacturer to unload the merchandise on the dock. The main problem is that often suppliers are not aware of the policy from retailers. Also, often suppliers are not equipped to unload their shipment. In this case, they have to request and pay for a helper to assist the truck driver to unload the merchandise on the distribution centre's dock.

Usually manufacturers have to reimburse the retailer for all unsalable merchandise and the damaged goods are thrown away. Now some retailers are charging to the supplier on pretty much each order some unsalable merchandise fees. This is even the case with dry grocery products, for which shelf life is not a problem. A note is sent to the manufacturer by the retailer and the amount of the unsalable merchandise is deducted from the payment. That amounts sometimes up to 1% and even 1.5% of dry grocery supplier annual sales.

Estimating total cost of changing trade practices

All those extra trade costs presented above represent significant revenue lost for manufacturers. It is possible to estimate the effect of these changing trade practices within two to four years of the business relationship. Those estimates represent percentage of sales given back to the retailer:

- 1% to 2% increase of marketing programs (O&A);
- increase in listing fees, representing 0.5% to 2% of sales;
- extra terms of 1% to 2%;
- extended payment period from 30 to 60 days representing 1% to 2% of revenue lost;
- lumping fees, representing of 0.25% to 1% of sales and

- unsalable merchandise representing 0.5% to 1.5% of sales

Changing trade practices can represent additional 3% to 7% of sales given back to the retailer within two to four years. These changing trade costs of doing business with national supermarket chains can significantly impact a manufacturers' profit margin. Manufacturers are probably accepting those changing trade conditions because they simply don't have the negotiation power to refuse them. Again, it is possible to debate these increasing costs, but it is likely that the retailer will favour the most cooperative suppliers in its merchandising activities.

Conclusion

Trade marketing terms and practices have been a source of controversy in the industry for at least the last forty years. The issue now is the effort by grocers to generate more margin and returns from the practice. In the end, those arbitrary and confused terms of trade can diminish the willingness of suppliers to collaborate with retailers on merchandising activities. Furthermore, it may contribute to adversarial relationships between manufacturers and retailers.

The irony of course is that for the most part, manufacturers are going to increase their list pricing in full knowledge that the grocer is going to be making these extra demands. It can become a sort of a shell game. The problem now, however, is that it is a moving target, at least until expectations and practices become clearer. The manufacturers that are able to produce and market the best brands and products that are in high demand will be the least affected. Everyone has to market Tide, Coke and Heinz. Also those suppliers, and even new suppliers, which can provide unique and innovative products will also be the least affected. Every grocer wants to have a good, new product. However, if it is another "me-too" product, line extension or another can of peas, the grocer demands will be great, and rightly so.

The bottom line is that it is important for emerging suppliers and new account managers to the supermarket trade to be aware of those changing practices. Awareness of this business context by planning trade marketing budgets realistically can only enhance the chances of success for manufacturer-grocer relationships.

Further to that point, Willard Bishop of Barrington, Illinois asserted in a recent edition of "Competitive Edge," that both retailers and manufacturers need to make trade promotions work to generate sales and margins. In order to do so, trade promotions manufacturers and retailers need to creating promotional strategies that merchants can follow when building promotional offers. These strategies should be based on comprehensive analyses and aligned to shoppers, vendors and category role. The strategies should also be aligned to offer frequency and seasonality, i.e., isolating the ideal number of times per year each category should be promoted and prioritizing individual weeks best suited for these promotions.

Willard Bishop asserts that successfully rolling out the strategy for long-term benefit involves the following:

- Benchmarks and metrics – Developing an analytical framework and tools to facilitate pre- and post promotion analyses, and establishing impact targets/thresholds that each

promotion must meet, with a strong focus on driving incremental sales through promotional activity.

- Technology – Adopting support technology such as promotion optimization systems to help enable and articulate the new promotional strategy focused on enhancing promotional effectiveness and increasing the incremental nature of promotions.
- Vendor interaction – Refining how to work with vendors throughout the year to proactively plan optimal promotions.

In conclusion, while the arguments may be old, the issue in Canada lately has been the arbitrary or inconsistent nature of the listing fees. Arbitrary and confused terms of trade will ultimately damage the trust and efficiency of the trade to the detriment of both parties. Trade promotions are not going away, but as Bishop notes, they can be a useful and constructive mechanism to drive profitable sales.

This paper is a compilation of articles that first appeared in the George Morris Centre publication, Grocery Trade Review. For a free two month trial subscription to Grocery Trade Review, contact Kevin Grier at kevin@georgemorris.org.